



SMALL BANK

Comptroller of the Currency
Administrator of National Banks

PUBLIC DISCLOSURE

December 2, 2002

COMMUNITY REINVESTMENT ACT PERFORMANCE EVALUATION

**Lone Star National Bank
Charter Number 17611**

**100 W. Ferguson
Pharr, TX 78577**

**Comptroller of the Currency
San Antonio South Field Office
10101 Reunion Place Boulevard, Suite 402
San Antonio, TX 78216**

NOTE: This document is an evaluation of this institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods consistent with safe and sound operation of the institution. This evaluation is not, nor should it be construed as, an assessment of the financial condition of this institution. The rating assigned to this institution does not represent an analysis, conclusion, or opinion of the federal financial supervisory agency concerning the safety and soundness of this financial institution.

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INSTITUTION'S CRA RATING

This institution is rated Outstanding.

The lending performance of Lone Star National Bank (LSNB) reflects an outstanding response to community credit needs, including low- and moderate-income individuals and areas. Factors that support the overall rating include:

- The loan-to-deposit ratio exceeds the standards for satisfactory performance. The average loan-to-deposit ratio, for the past eighteen quarters, was 76 percent, which exceeds other similarly situated institutions in the assessment areas.
- A substantial majority of originated loans are located within the assessment areas (AA's). Based on our sample, 88 percent of the number of loans and 88 percent of the dollar volume of loans were made within the AA's.
- The distribution of a sample of loans reflects good penetration among businesses of different sizes. The distribution of loans to individuals of different income levels is strong considering actual lending performance along with community development lending and investment efforts.
- The geographic distribution of a sample of loans reflects reasonable dispersion throughout the assessment areas, given the demographic characteristics of the assessment areas.

DESCRIPTION OF INSTITUTION

Lone Star National Bank (LSNB) is an independently owned community bank headquartered in Pharr, Texas. Since the previous CRA evaluation of April 1998, the bank has opened branches with one in Rio Grande City (August 2000), one in Brownsville (July 2001), and one in Edinburg (September 2002). The bank now operates six branches and the main office. Automated teller machines are located at each location.

LSNB is a wholly owned subsidiary of Lone Star National Bancshares – Texas, Inc., a one-bank holding company with assets of \$568 million as of September 30, 2002. As of September 30, 2002, LSNB had total assets of \$569 million with net loans of \$325 million, which represent 57 percent of total assets and 62 percent of total deposits. The corporate structure of the bank has not changed from the previous evaluation period.

LSNB offers a wide range of products and services. Primary loan products include commercial real estate loans, commercial loans (including small businesses), and residential real estate loans.

The previous CRA Performance Evaluation, dated April 27, 1998, reflected a satisfactory rating. There are no legal or other impediments that limit LSNB's ability to help meet the credit needs in its assessment areas. The following table depicts the composition of the loan portfolio as of September 30, 2002.

Loan Category	\$ (000)	%
Commercial Real Estate Loans	132,200	41%
Commercial Loans	94,458	29%
Residential Real Estate Loans	51,754	16%
Consumer Loans	25,141	7%
Agricultural Loans	14,727	5%
Other Loans	6,773	2%
Total	325,053	100%

DESCRIPTION OF HIDALGO COUNTY ASSESSMENT AREA

The bank identified Hidalgo County as an AA. It includes the McAllen-Edinburg-Mission metropolitan statistical area (MSA). The MSA is named for its three largest cities, which are essentially adjacent to each other. The defined AA complies with the requirements of the CRA. Bank activities within the Hidalgo County AA received a full-scope review.

Main competitors in the AA, in terms of total assets, are locally based Texas State Bank, First National Bank, Inter National Bank, Alamo Bank, and several smaller community banks. Several regional and multi-state banks also have branches in Hidalgo County, primarily in the city of McAllen. These competitors include Chase Manhattan Bank, International Bank of Commerce, and Frost National Bank. Hidalgo County deposits account for 71 percent of LSNB's total deposits. The bank operates five, full-service locations and five ATMs in Hidalgo County. As of June 30, 2002, LSNB ranked sixth in deposits with a market share of 6.41 percent. LSNB offers a full-range of products and services, with particular emphasis on financing for commercial and real estate purposes.

The MSA continues to experience a population surge largely associated with the many cross-border trade opportunities. The MSA's economy more than doubled in size in the 1990s making it the fourth fastest-growing MSA in the nation. Major employment sectors include services, trade, and government. The city of McAllen is regarded as the retail center of South Texas. Agricultural production continues to decline as the area becomes more urbanized.

Hidalgo County has posted consistent employment growth in recent years. However, the 2001 annual unemployment rate for Hidalgo County was 13.1 percent. The October 2002 unemployment rate of 11.6 percent is significantly higher than the state (6.2 percent) and national (5.7 percent) averages; however, the rate continues to improve.

A high demand exists for purchase money mortgage loans in the trade area. The demand is attributed to the high growth in the McAllen-Edinburg-Mission MSA. The growth is being led by the city of McAllen, where the average cost of a new home is \$104 thousand. In the entire county, the average cost of a new home is \$72 thousand. Demand for low- and moderate-income housing remains high, especially given the high poverty level and the high unemployment rate.

We contacted a local economic development corporation. A corporate official identified small business financing and affordable housing as credit needs in the local community. A community contact performed in conjunction with another national bank CRA examination identified loans to small businesses as a primary credit need. Government and non-profit organizations in the county are the primary vehicles for providing home ownership counseling, construction, and financing of affordable homes. Portions of Hidalgo County are identified as one of ten federally-designated Empowerment Zones in the nation, primarily for affordable housing. The following table reflects additional demographic data for the AA.

Demographic and Economic Characteristics – Hidalgo County AA	
<i>Population</i>	
Number of Families	88,615
Number of Households	103,514
<i>Geographies</i>	
Number of Census Tracts/BNA	63
% Low-Income Census Tracts/BNA	0%
% Moderate-Income Census Tracts/BNA	30%
% Middle-Income Census Tracts/BNA	43%
% Upper-Income Census Tracts/BNA	27%
<i>Median Family Income (MFI) – MSA</i>	
1990 MFI for AA	\$17,619
2000 HUD-Adjusted MFI	\$28,000
2001 HUD-Adjusted MFI	\$29,100
<i>Economic Indicators</i>	
Unemployment Rate – October 2002	11.6%
1990 Median Housing Value	\$38,999
% of Households Below Poverty Level	37%

DESCRIPTION OF CAMERON COUNTY ASSESSMENT AREA

LSNB designated Cameron County as an AA. It includes the Brownsville-Harlingen-San Benito MSA. The defined AA area meets the requirements of the CRA, and does not arbitrarily exclude any low- or moderate-income tracts. Activities in the Cameron County AA received a full-scope review.

LSNB faces strong competition in the Brownsville market from multinational and regional banking companies, i.e.: Wells Fargo, Chase Bank of Texas, Bank of America, and Texas State Bank. International Bank of Commerce-Brownsville, part of a \$6 billion holding company, with \$619 million in assets also has a significant presence. Several other Rio Grande Valley community banks have branches in the AA. As of June 30, 2002, Cameron County deposits account for 26 percent of LSNB's total deposits. LSNB ranks seventh in deposits with a market share of 4.48 percent. The bank operates one full-service branch and one ATM in the AA. LSNB offers a full-range of banking products and services in this AA, with particular emphasis on financing for commercial and real estate purposes. Demographics and economic conditions in Cameron County are very similar to Hidalgo County.

The major employment sectors include services, trade, government, and manufacturing, with emphasis on assembly production. The agriculture sector has declined due to market price fluctuations and continued urbanization. The unemployment rate is 10.2 percent as of October 2002. It is higher than the 2001 annual unemployment rate of 9.2 percent, and higher than the current state and national averages of 6.2 percent and 5.7 percent, respectively.

Market data on HMDA lending indicates there is a lower than average demand for purchase money mortgage loans in the bank's trade area. The high level of families below the poverty level, coupled with the high unemployment rate, means many cannot qualify for home mortgage loans. This AA does not have the high growth levels that the Hidalgo County AA has to help mitigate these factors.

Community contacts performed in conjunction with CRA examinations of other financial institutions identified the continued need for more affordable housing and small business financing. The contacts also mentioned the financial needs of new small businesses and the lack of smaller homes for the growing number of people retiring to South Texas. The following table reflects additional demographic information for the AA.

Demographic and Economic Characteristics – Cameron County AA	
<i>Population</i>	
Number of Families	60,903
Number of Households	73,550
<i>Geographies</i>	
Number of Census Tracts/BNA	64
% Low-Income Census Tracts/BNA	2%
% Moderate-Income Census Tracts/BNA	28%
% Middle-Income Census Tracts/BNA	39%
% Upper-Income Census Tracts/BNA	28%
% No Income Census Tracts/BNA	3%
<i>Median Family Income (MFI) – MSA</i>	
1990 MFI for AA	\$18,731
2000 HUD-Adjusted MFI	\$27,900
2001 HUD-Adjusted MFI	\$29,100
<i>Economic Indicators</i>	
Unemployment Rate – October 2002	10.2%
1990 Median Housing Value	\$45,518
% of Households Below Poverty Level	34%

DESCRIPTION OF STARR COUNTY ASSESSMENT AREA

LSNB designated Starr County as an AA. It does not include any metropolitan statistical areas. The defined AA area meets the requirements of the CRA, and does not arbitrarily exclude any low- or moderate-income tracts. Activities in the Starr County AA received a full-scope review.

LSNB faces strong competition in the county from Texas State Bank, a regional bank with two branches in the county, and from International Bank of Commerce, which has three branches in the county. Two other Rio Grande Valley community banks have branches in the AA. As of June 30, 2002, Starr County deposits account for 3 percent of LSNB's total deposits. LSNB ranks fifth in deposits with a market share of 5.14 percent. The bank operates one, full-service branch and one ATM in the AA. LSNB offers a full-range of banking products and services in this AA, with particular emphasis on financing for commercial and real estate purposes.

Demographics and economic conditions in Starr County are similar to those reported for Hidalgo and Cameron Counties. The major employment sectors include retail trade and services. The unemployment rate is 15.4 percent as of October 2002. It has decreased from the 2001 annual unemployment rate of 20 percent; however, it remains significantly higher than the state and national averages of 6.2 percent and 5.7 percent, respectively.

Market data on HMDA lending indicates a lower than average demand for purchase money mortgage loans in this AA. The high level of families below the poverty level, coupled with the high unemployment rate, means many cannot qualify for home mortgage loans. This AA does not have the high growth levels that the Hidalgo County AA has to help mitigate these factors.

A community contact performed by another regulatory agency identified the continued need for more affordable housing and small business financing. The following table reflects additional demographic data for the AA.

Demographic and Economic Characteristics – Starr County AA	
<i>Population</i>	
Number of Families	9,235
Number of Households	10,379
<i>Geographies</i>	
Number of Census Tracts/BNA	6
% Low-Income Census Tracts/BNA	83%
% Moderate-Income Census Tracts/BNA	17%
% Middle-Income Census Tracts/BNA	0%
% Upper-Income Census Tracts/BNA	0%
<i>Median Family Income (MFI) – Texas Statewide</i>	
1990 MFI for AA	\$24,585
2000 HUD-Adjusted MFI	\$34,700
2001 HUD-Adjusted MFI	\$35,800
<i>Economic Indicators</i>	
Unemployment Rate – October 2002	15.4%
1990 Median Housing Value	\$22,774
% of Households Below Poverty Level	58%

CONCLUSIONS ABOUT PERFORMANCE CRITERIA

LSNB has demonstrated an outstanding performance in meeting credit needs of its AA's. Our review focused on the bank's primary lending products, which included small business lending and residential (home purchase, home improvement, and refinancing) loans. To determine the level of residential lending in the AA's, we reviewed all residential loans on the Home Mortgage Disclosure Act (HMDA) report for 1999, 2000, and 2001. For commercial loans and for other criteria, we used a random sample as indicated in the following sections. Our sample of these loan products was used to determine both the extent of lending (within the assessment area) as well as the dispersion throughout the demographics of the AA's.

During the CRA evaluation, management submitted non-public data for CD loans, investments, and services for our consideration. The data was reviewed to ensure it qualified as community development. Based on verification work performed, publicly reported lending data and non-public CD data are considered accurate. All the data reported for the above categories was used in this evaluation.

Loan-to-Deposit Ratio

LSNB's loan-to-deposit ratio exceeds the standards for satisfactory performance. As shown in the following table, the average loan-to-deposit ratio over the past eighteen quarters compares favorably with the averages reported by similarly situated financial institutions in the assessment area. The two financial institutions used for comparison purposes are headquartered in Hidalgo County, have similar branch structure and numbers of branches, and have similar primary lending products. Twenty other financial institution branches are located in the assessment areas; however, loan-to-deposit ratios for individual branches are not published.

Institution	Assets (as of 9/30/02)	Average LTD Ratio
Alamo Bank of Texas	\$218,106	70.71
Inter National Bank	\$605,562	58.32
<i>Lone Star National Bank</i>	<i>\$569,205</i>	<i>76.08</i>

Lending in Assessment Area

LSNB exceeds the standards for satisfactory performance in this category. A substantial majority of all loan originations are located within the AA's. The following table reflects, that in all loan categories sampled, a majority of the loans were located in the AA's.

TOTAL LOANS REVIEWED								
LOAN TYPE	IN ASSESSMENT AREA				OUT OF ASSESSMENT AREA			
	#	%	\$ (000s)	%	#	%	\$ (000s)	%
Commercial	59	95%	3,356	96%	3	5%	125	4%
1999 HMDA-LAR	223	95%	12,115	83%	12	5%	2,410	17%
2000 HMDA-LAR	206	88%	14,053	96%	28	12%	554	4%
2001 HMDA-LAR	240	85%	13,967	87%	44	15%	2,176	13%
Total Reviewed	728	89%	43,491	89%	87	11%	5,265	11%

Lending to Borrowers of Different Incomes and to Businesses of Different Sizes

Overall, LSNB exceeds the standards for satisfactory performance with a reasonable distribution of loans to individuals of different income levels and to businesses of different sizes. Our sample of business lending noted an overall good penetration to businesses with annual revenues less than or equal to \$1 million. The bank's efforts in community development lending and investments added to the performance in this category and resulted in the bank exceeding the standards for satisfactory performance.

Hidalgo County AA

A sample of business loans reflected good penetration for businesses with annual revenues less than or equal to \$1 million. The following table reflects the bank's loans to small businesses by total annual revenues.

BORROWER DISTRIBUTION OF SMALL LOANS TO BUSINESSES – Hidalgo County AA		
Business Revenues	≤\$1,000,000	>\$1,000,000
% of AA Businesses	92%	8%
% of Bank Loans in AA #	92%	8%
% of Bank Loans in AA \$	90%	10%

Our analysis of residential lending activity reflected totals that were lower than those reflected in the demographic data as reported in the census reports for both low- and moderate-income families. The low percentages are reasonable given that 37 percent of the households in the assessment area are below the poverty level. Based on 2001 HUD-updated metropolitan statistical area median family income of \$29,100, low-income is calculated as income less than \$14,550. This level would make it difficult for borrowers to qualify for residential loan products, especially when the 1990 median housing value in the assessment area was \$38,999. Although median family income has increased from the \$17,619 reported at the 1990 Census, housing costs have increased at a much faster pace than income levels. The following table reflects the residential lending to families by income level.

RESIDENTIAL REAL ESTATE – Hidalgo County AA								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Families	25%		16%		17%		42%	
LOANS BY YEAR	% of Number	% of Amount						
1999	4%	1%	13%	3%	15%	9%	68%	87%
2000	0%	0%	6%	4%	37%	38%	57%	58%
2001	0%	0%	10%	2%	37%	42%	53%	56%
Total	2%	1%	10%	3%	27%	28%	61%	68%

Cameron County AA

Our analysis of business loans reflected good penetration for businesses with annual revenues less than or equal to \$1 million. The following table reflects the bank’s loans to small businesses by total annual revenues.

BORROWER DISTRIBUTION OF SMALL LOANS TO BUSINESSES – Cameron County AA		
Business Revenues	≤\$1,000,000	>\$1,000,000
% of AA Businesses	93%	7%
% of Bank Loans in AA #	92%	8%
% of Bank Loans in AA \$	90%	10%

Our analysis of residential lending activity reflected totals that were lower than those reflected in the demographic data as reported in the census reports for low-income families. The level of lending to moderate-income families exceeds the level of moderate-income families in the AA. Households, which fall below the poverty level, represent 34 percent of the total households in the AA. The calculated level of income which distinguishes this household segment (less than \$14.5 thousand in income) clearly inhibits those households from qualifying for residential loan products when consideration is given to the weighted average cost of housing which exceeds \$38 thousand (based on 1990 Census Data information). The following table reflects residential lending to families by income level.

RESIDENTIAL REAL ESTATE – Cameron County AA								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Families	25%		16%		17%		42%	
LOANS BY YEAR	% of Number	% of Amount						
2001	7%	7%	33%	8%	47%	57%	13%	28%
Total	7%	7%	33%	8%	47%	57%	13%	28%

Starr County AA

A sample of business loans reflected strong penetration for businesses with annual revenues less than or equal to \$1 million. The following table reflects the bank’s loans to small businesses by

total annual revenues.

BORROWER DISTRIBUTION OF SMALL LOANS TO BUSINESSES – Starr County AA		
Business Revenues	≤\$1,000,000	>\$1,000,000
% of AA Businesses	96%	4%
% of Bank Loans in AA #	100%	0%
% of Bank Loans in AA \$	100%	0%

Our analysis of residential lending activity reflected totals that were lower than those reflected in the demographic data for low-income families. The low percentage is reasonable given that approximately 58 percent of the households in the AA are below the poverty level. The 2001 HUD-updated median family income of \$35,800 is based on the Texas statewide non-metropolitan statistical area median family income. The actual median family income of Starr County, as reported in 1990 Census Data, was \$10,839. Based on the actual median family income level, low-income is calculated as income less than \$5,420. This extremely low level would make it difficult for borrowers to qualify for residential loan products, especially when the 1990 median housing value in the assessment area was \$22,774. The following table reflects the residential lending to families by income level.

RESIDENTIAL REAL ESTATE – Starr County AA								
Borrower Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Families	56%		17%		12%		15%	
LOANS BY YEAR	% of Number	% of Amount						
2001	15%	10%	23%	15%	23%	20%	38%	56%
Total	15%	10%	23%	15%	23%	20%	38%	58%

Geographic Distribution of Loans

The overall geographic distribution of loans within the AA’s meets the standards for satisfactory performance. The following tables reflect that the distribution is comparable to the demographic data. The samples used to determine geographic distribution are the same samples used to evaluate lending to borrowers of different incomes and businesses of different sizes.

Hidalgo County AA

The following tables reflect lending volume within the moderate-income census tracts is not comparable to demographic data. However, six moderate-income census tracts are business districts or industrial tracts, which limit residential lending opportunities in these areas. Several other moderate-income census tracts are not located in close proximity to bank facilities and may be served by other financial institution competitors in the area. Business growth in the AA has

been along U.S. Highway 83 and U.S. Highway 281. A significant portion of the census tracts that include these highways are designated either middle- or upper-income.

BUSINESS LOANS – Hidalgo County AA								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Businesses	0%		21%		42%		37%	
	% of Number	% of Amount						
	0%	0%	10%	23%	45%	31%	45%	46%

RESIDENTIAL REAL ESTATE – Hidalgo County AA								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Owner Occupied	0%		24%		49%		27%	
LOANS BY YEAR	% of Number	% of Amount						
1999	0%	0%	10%	5%	39%	26%	51%	69%
2000	0%	0%	13%	4%	37%	39%	50%	57%
2001	0%	0%	16%	2%	16%	8%	68%	90%
Totals	0%	0%	12%	5%	33%	26%	55%	69%

Cameron County AA

The following tables reflect lending volume within the moderate-income census tracts is comparable to the level reported in demographic data.

BUSINESS LOANS – Cameron County AA								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Businesses	1%		25%		41%		33%	
	% of Number	% of Amount						
	0%	0%	47%	43%	26%	40%	27%	17%

RESIDENTIAL REAL ESTATE – Cameron County AA								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Owner Occupied	1%		22%		50%		27%	
LOANS BY YEAR	% of Number	% of Amount						
2001	7%	9%	36%	9%	43%	50%	14%	32%

Starr County AA

The AA only includes low- and moderate-income census tracts. The following tables reflect lending volume is comparable to demographic data and exceeds the standards for satisfactory

performance.

BUSINESS LOANS – Starr County AA								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Businesses	81%		19%		0%		0%	
	% of Number	% of Amount						
	75%	88%	25%	12%	0%	0%	0%	0%

RESIDENTIAL REAL ESTATE – Starr County AA								
Census Tract Income Level	LOW		MODERATE		MIDDLE		UPPER	
% of AA Owner Occupied	88%		12%		0%		0%	
LOANS BY YEAR	% of Number	% of Amount						
2001	77%	87%	23%	13%	0%	0%	0%	0%

Qualified Investments

The level of community development investments and lending is reasonable and had a very positive impact on the borrower distribution conclusion and therefore the overall performance conclusions.

Community Development Investments

During the evaluation period, LSNB made several qualified community development investments, which include a \$100,000 equity investment in a certified Community Development Financial Institution and a \$1,000,000 investment in revenue bonds that specifically support affordable housing. These investments address an identified need in the Hidalgo and Cameron County AA's. The funds were used for multifamily affordable housing projects.

LSNB sponsors several affordable housing related projects made possible by grants from the Federal Home Loan Bank of Dallas. The grant money to the organizations, along with assistance from other public and private entities, allows the organizations to build affordable homes for low- and moderate-income households in the Hidalgo and Cameron County assessment areas.

LSNB made several qualifying donations to community service groups, including Community Development Corporation of South Texas, McAllen Hispanic Chamber of Commerce, Valley Alliance of Mentors for Opportunities & Scholarships, and the United Way. These programs are targeted toward and primarily benefit low- and moderate-income families and geographies. The bank made a \$1,250 qualifying grant to the Community Development Corporation of South Texas. The donation, coupled with other bank contributions allowed the corporation to receive a \$20,000 grant from the Federal Home Loan Bank of Dallas, so it could develop new affordable

housing initiatives in South Texas modeled after the McAllen Affordable Housing program.

Community Development Loans

LSNB has made a reasonable level of community development loans in the Hidalgo County and Cameron County AA's. Examples of these loans include:

The bank made a \$925 thousand loan to a corporation that develops lots to be purchased by a community development corporation for affordable housing targeted to low-income households.

The bank has made loans totaling in excess of \$1.1 million to a corporation that deals with low-income housing in the Hidalgo County AA. The purpose of the loan was to help finance the cost of construction and home rehabilitation for low- and moderate-income residents who do not qualify for conventional home loans.

The bank made a \$3.5 million loan to a local economic development corporation. The purpose of the loan was to provide community services by renovating a facility in the Hidalgo County AA that will primarily benefit low-and moderate-income individuals by offering job training and job placement to combat the high unemployment rate.

Responses to Complaints

During this evaluation period, LSNB has not received any consumer complaints regarding its CRA performance.

Fair Lending Review

An analysis of public comments and consumer complaint information from 1998 through 2002 was performed according to the OCC's risk based fair lending approach. Based on its analysis of the information, the OCC decided that a comprehensive fair lending examination would not need to be conducted in connection with the CRA evaluation this year. The latest comprehensive fair lending exam was performed in 1998.